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Trade Policy of Nepal: Review and Repercussions

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INTRODUCTION

International trade contributes to growth and development in a less-developed country (LDC) in many ways. If a trade strategy is properly implemented, it expands output and provides additions to incomes through demand for local natural resources. More generally, it permits a developing economy to specialize, based on its relatively ample resources, while importing goods and services that would be very expensive or impossible to produce locally. Hence, the country can potentially acquire more of each kind of output than it could produce for itself through trade.[1] Secularly increasing trade then assists in maintaining growth in per capita income as long as specialization increases efficiency.[2]

Benefits from trade are also hinged on economies of scale, that is, advantages from large-scale production. The size of the market limits the extent of the division labour, and thus the output attainable per worker in any economy. A LDC offers only very small markets for most industrial products, so that it will be impoverished by the high unit costs if it attempts in producing a little of each product for its insufficient domestic market. Such a country can gain considerably by importing most of the goods that can be produced cheaply only on a large-scale, and by building its manufacturing industries partly around exports, so that a larger-scale of production can be achieved.

By enhancing incomes, trade expands demand, thereby enlarging opportunities for learning and a productive division of labour. Simultaneously, it amplifies the resources available for processes of savings, investment and accumulation including not only investment in physical capital, but also investment in intangible assets such as "human capital."[3]

It furnishes through imports, a supply of capital equipment, technical assistance, raw materials and other major inputs crucial for industrial development, augmenting local supply capabilities where they are weakest or non-existent.

Foreign trade can also serve as a positive "externality" to the whole economy intensifying competitive pressure and managerial efficiency and accelerating technical progress by greater foreign contacts.[4]

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Although improved performance was recorded during 1983/84 and 1984/85 due to the rise in exports of carpets and readymade garments, the current account deficit was still 7.2 percent of GDP, a steep rise from the 1 percent of 1975/76. The overall balance of payments deficits during these two years were primarily ascribed to enormous commercial imports from India. On the one hand, the exchange rate of the Nepalese rupee vis-a-vis the Indian rupee had remained virtually unchanged while on the other the exchange rate of the Nepalese rupee against all other currencies had been fairly unstable. Further, while imports from India did not require any licensing procedure, imports from countries other than India were subject to licensing and rationing arrangements. Both the unpredictability of the exchange rates of the major currencies and the licensing system seem to have led toward more substantial increments in the commercial imports from India, and ultimately to the balance of payments deficits during these years.

During the Plan period, certain changes in the composition and nature of export items occurred. Till the end of the Fifth Plan, jute had occupied the most prominent place in the list of items exported to overseas countries. However, during the Sixth Plan this position was surpassed by woolen carpets.[9] Unprocessed and semi-processed goods which accounted for 91 percent of the total exports to India fell down to 39 percent by 1983/84. Some improvements occurred in the export of leather and hides, garments, handicrafts and dried ginger.

Some reasons for the poor performance of the foreign trade sector are summarized below: a) lack of pertinent infrastructures; b) recession in the international market and the paucity of markets for primary products; c) limited finished exportable commodities; and d) increase in prices of construction materials, petroleum products, chemical fertilizers and other such commodities which exerted upward pressures on imports.

The Seventh Plan (1985/86-1989/90)

The principal objectives of the Seventh Plan with regard to the trade sector are: a) to create a favourable balance of payments situation; b) to build up essential infrastructures for the smooth and well-managed imports of goods and commodities necessary for economic growth; and c) to optimize the benefits of foreign trade by making the transit system more efficient and less expensive.[10]

To attain the above targets, programmes are to be launched of which the major ones include the following: a) a sound plan would be developed and implemented to enhance the export sector via an expansion in domestic production coupled with the standardisation of the produced goods and commodities; b) the private sector's involvement in the export sector would be boosted and protection would be provided to the interests of the private sector without prejudice to the national interest; c) considerable stress would be accorded to goods essential for national development, whereas imports of other goods would be curtailed; d) the structure of import trade would be remodelled both on a commodity-wise and country-wise basis in conformity with the trends associated with the balance of payments situation; and e) new transit facilities would be introduced in addition to the existing ones for reducing the exorbitant transit costs.

Trade data reveal that during the first four years of the Seventh Plan, exports soared from Rs. 3078.0 mil. in 1985/86 to Rs. 4155.4 mil. in 1988/89, an average annual rise of 12 percent. Although total exports took an upward turn, exports to India declined by almost 19 percent due to considerable loss in the export of pulses, rice, herbs, raw jute as well as jute goods between the period 1984/85 and 1986/87 (see Table 4). A parallel story can be told for 1987/88 (see Tables 1 and 4).

However, in the third year of the Plan (1987/88), exports to India had registered an increment of 20 percent over the previous year arising from increased export of primary goods such as mustard, linseeds, and jute goods, *inter alia*. But, it failed to reach the level of 1984/85. The figure for 1988/89 has nosedived to Rs. 990.6 mil. mainly because of the expiry of Nepal-India Trade and Transit Treaties in March, 1989.

Exports to Third Countries almost increased two-fold from Rs. 1836.9 mil. in 1985/86 to Rs. 3164.8 mil., which was tantamount to an average annual growth rate of 22 percent. This was principally because of an augmentation in cottage industry products such as carpets. Nonetheless, exports to Third Countries declined by 8.1 percent from Rs. 1836.9 mil. in 1985/86 to Rs. 1688.8 mil. in 1986/87, arising from a reduction in the export of raw jute, hides and skins, pulses, and readymade garments (see Table 3).

Imports accelerated by an average annual rate of more than 20 percent between 1985/86 and 1988/89, the figures being Rs. 9341.2 mil. and Rs. 16240.5 mil., respectively. Imports from India augmented annually by 2.3 percent, and overseas imports rose by almost 31 percent. Huge increases in the import of construction materials, POL products, and fertilizers brought about such an atmosphere.

Indeed, between 1985/86 and 1988/89, imports grew nearly twice rapidly as exports. The overall picture tends to imply that there is a high propensity to import for consumption and intermediate use without generating a matching growth of output and tradeables.

Consequently, the trade deficit widened between 1985/86 and 1988/89 as the figures stood at Rs. 6263.2 million and Rs. 12085.1 million, respectively, registering a growth rate of 24.5 percent per annum. Trade deficit with India and overseas countries grew at an annual rate of 5.8 percent and 35.9 percent, respectively.

The Eighth Plan (1991/92-1995/96)

The Eighth Plan which was expected to take off in 1990/91 has been postponed for a year. The main trade policy should be focussed on export-oriented development and planned imports of development and capital-intensive goods ensuring national economic growth to be self-sustain-

Table 1
Direction of Foreign Trade: 1975/76-1988/89

(In Million Rupees)

	1975/76	1976/77	1977/78	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89P
Total Exports	1185.8	1164.7	1046.2	1296.8	1150.5	1608.7	1491.5	1132.0	1703.9	2740.4	3078.0	2991.0	4114.6	4155.4
To India	893.7	779.6	498.1	650.9	520.9	992.4	994.4	843.2	1160.7	1601.7	1241.1	1302.6	1567.8	990.6
To Other Countries	292.1	385.1	548.1	646.7	629.6	616.3	497.1	288.8	543.2	1138.9	1836.9	1688.8	2546.8	3164.8
Total Imports	1981.7	2008.0	2469.6	2884.7	3480.1	4428.2	4930.3	6314.0	6514.3	7742.1	9341.2	10905.4	23869.6	16240.5
From India	1227.1	1343.5	1534.1	1581.7	1786.4	2179.0	2280.9	2499.6	3058.0	3895.8	3970.9	4262.1	4595.8	4216.2
From Other Countries	754.6	664.5	935.5	1303.0	1693.7	2249.2	2649.4	3814.4	3456.3	3846.3	5370.3	6643.3	9273.8	12024.3
Trade Balance	-795.9	-843.3	-1423.4	-1587.9	-2329.6	-2819.5	-3438.8	-5182.0	-4810.4	-5001.5	-6263.2	-7914.0	-9755.0	-12085.1
With India	-333.4	-563.9	-1036.0	-931.6	-1265.5	-1186.6	-1286.5	-1656.4	-1897.3	-2294.1	-2729.8	-2959.6	-3028.0	-3225.6
With Other Countries	-462.5	-279.4	-387.4	-656.3	-1064.1	-1632.9	-2152.3	-3525.6	-2913.1	-2707.4	-3563.4	-4954.4	-6727.0	-8859.5

P = Provisional.

Sources: 1) Ministry of Finance: Economic Survey, Various Issues.
2) Trade Promotion Centre.
3) Nepal Rastra Bank, Unpublished Data.

Table 2.
Commodity Trade by SITC Group

(In Million Rupees)

SITC Group	1975/76	1976/77	1977/78	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88	1988/89P
EXPORTS	1185.8	1164.7	1046.2	1296.8	1150.5	1608.7	1491.5	1132.0	1703.9	2740.6	3078.0	2991.4	4114.5	4155.4
Food & Live Animals	804.0	599.5	405.3	488.8	306.5	588.7	735.9	327.7	584.1	992.1	835.6	703.7	804.4	540.5
Tobacco & Beverages	4.0	12.3	11.2	13.6	2.6	15.4	18.4	13.3	5.3	5.0	0.2	3.5	10.1	5.0
Crude Materials Inedibles	226.3	377.8	441.2	491.7	469.6	561.6	397.3	335.4	372.7	486.8	412.9	491.1	513.7	245.2
Mineral Fuels & Lubricants	1.7	0.5	0.2	0.7	0.5	0.4	1.0	0.7	3.3	1.0	0.2	0.2	0.8	-
Animal & Vegetable Oil & Fats	1.8	5.3	6.0	16.5	20.4	37.8	44.0	42.2	67.6	57.1	61.3	117.1	171.4	98.1
Chemicals & Drug	9.3	10.6	3.6	0.8	1.3	3.9	1.5	1.8	6.3	1.2	2.5	2.0	12.6	24.3
Manufactured Goods Classified by Materials	104.7	123.9	123.3	229.1	291.8	254.3	225.4	357.3	581.6	649.1	899.9	1009.6	1601.6	1986.6
Machinery & Transport Equipment	3.7	1.6	2.7	2.9	3.2	1.8	9.1	7.9	24.5	33.7	38.6	2.6	0.5	5.7
Miscellaneous Manufactured Articles	23.0	27.7	51.2	52.4	54.0	143.0	58.1	44.6	57.7	513.4	826.5	661.5	996.8	1250.1
Commodity & Transaction not Classified	7.3	5.5	1.5	0.3	0.6	1.8	0.8	0.1	0.8	1.2	0.3	0.2	2.5	-
IMPORTS	1981.7	2008.0	2469.7	2884.7	3480.2	4428.2	4930.2	6314.0	6514.3	7742.1	9341.2	10905.2	13869.6	16240.5
Food & Live Animals	291.1	249.3	323.1	292.0	412.9	601.2	619.2	924.7	728.4	782.9	971.1	1028.9	1523.7	1291.1
Tobacco & Beverages	42.4	20.2	44.2	35.7	25.9	24.8	35.6	62.5	71.8	79.4	112.9	144.0	172.2	203.7
Crude Materials Inedibles	88.7	36.4	53.1	61.4	100.9	115.5	142.6	206.3	266.2	424.5	393.0	657.2	1036.9	1165.4
Mineral Fuels & Lubricants	211.7	249.0	250.4	232.4	409.7	583.6	579.3	701.9	749.2	918.8	1054.0	929.5	1049.9	1128.4
Animal & Vegetable Oil and Fats	7.4	8.3	30.8	22.4	26.0	92.5	64.3	66.3	78.5	112.7	101.9	175.9	352.7	345.6
Chemicals & Drug	190.1	224.5	254.9	297.5	396.7	527.3	599.2	646.0	698.4	908.0	1170.2	1287.6	1495.4	1541.4
Manufactured Goods Classified by Materials	545.9	660.6	819.2	1084.7	1089.9	1259.2	1555.5	1936.8	1801.9	2376.9	2759.5	3226.9	3359.2	4678.8
Machinery & Transport Equipment	413.4	375.5	483.1	574.7	719.7	802.9	892.0	1180.9	1651.2	1671.4	2134.7	2784.1	4143.7	4861.2
Miscellaneous Manufactured Articles	168.4	145.8	201.0	275.0	288.3	407.6	430.2	584.3	466.3	450.6	637.2	664.0	729.1	1020.2
Commodity & Transaction not Classified	22.6	38.4	9.9	8.9	10.2	13.6	12.3	4.3	2.4	6.9	6.7	7.3	7.0	4.7

P = Provisional. Sources: (1) Nepal Rastra Bank. (2) Ministry of Finance.

Table 3
Export of Major Commodities to Overseas Countries

(In Million Rupees)

Commodities	1975/76	1976/77	1977/78	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88
Raw Jute	64.5	100.3	170.0	158.6	119.6	94.7	62.6	13.7	-	-	28.9	21.6	30.3
Jute Goods	56.2	58.6	63.2	124.8	115.0	28.6	1.5	-	-	-	-	-	0.4
Pulses	28.3	18.5	-	20.1	81.9	40.1	58.2	3.0	6.0	108.6	240.4	100.6	4.0
Rice	-	-	138.5	243.9	39.4	-	86.1	-	-	-	-	-	-
Linseed	15.7	4.0	7.3	-	-	-	-	-	-	-	-	-	-
Oil Cake	1.4	18.2	8.1	11.2	3.5	0.4	-	-	-	-	-	-	-
Rice Brancake	2.4	3.1	7.1	-	-	1.2	-	-	-	-	-	-	-
Turmeric	0.4	1.1	10.7	-	-	-	-	-	-	-	-	-	-
Cardamom (Large)	18.8	13.3	11.9	22.2	16.4	18.0	7.4	5.8	6.5	14.6	25.7	43.3	20.0
Medicinal Herbs	6.3	5.8	5.5	4.4	1.5	0.9	0.5	0.5	0.6	0.8	0.3	0.1	0.2
Bristle	3.1	3.2	2.2	1.6	-	-	0.1	-	-	-	-	-	-
Wollen Goods	2.8	3.9	5.0	5.5	6.7	10.2	5.1	4.8	3.9	4.6	3.8	5.3	9.0
Hides & Skins	24.9	55.1	76.3	128.9	211.6	137.4	93.3	95.1	155.6	242.9	233.2	161.0	165.4
Carpets (Hand Knotted Wollen)	9.3	27.9	23.9	45.8	55.4	65.0	84.0	137.8	265.4	249.4	376.4	627.5	1223.7
Readymade Garments	2.0	4.0	5.7	8.5	7.8	13.0	13.8	10.0	20.5	470.9	803.7	611.2	916.6
Handicrafts	12.7	20.5	34.3	41.5	43.0	100.2	12.2	9.4	12.6	12.7	17.7	32.4	53.8
Miscellaneous	4.0	18.0	18.0	21.7	70.9	45.1	35.2	8.0	3.5	11.7	29.1	57.9	120.8

Source: 1) Ministry of Finance: Economic Survey, Varipus Issues.
2) Trade Promotion Centre.
3) Nepal Rastra Bank: Quarterly Economic Bulletin, Various Issues.

Table 4

Export of Major Commodities to India

(In Million Rupees)

Commodities	1975/76	1976/77	1977/78	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88
Timber	54.1	103.4	146.7	176.7	136.1	226.2	87.2	28.8	7.9	25.7	-	-	-
Rice (Husked)	495.4	343.0	46.5	13.3	2.9	117.6	136.5	11.3	75.7	250.0	93.2	14.4	-
Maize	-	1.4	4.7	4.9	2.7	24.5	26.1	0.3	0.4	10.9	-	-	-
Mustard & Linseeds	40.3	31.1	4.5	-	-	-	-	-	75.5	25.6	58.1	103.1	141.3
Herbs	2.8	6.3	6.5	5.2	13.5	16.5	6.4	5.9	8.0	27.9	16.6	8.1	16.4
Ghee	60.5	35.8	33.2	46.0	21.2	54.0	26.2	36.8	45.8	39.4	47.0	46.6	46.7
Dried Ginger	15.0	27.3	16.1	14.2	8.6	10.8	15.3	19.3	37.1	38.7	30.3	35.2	37.3
Raw Jute	-	-	-	2.1	12.9	46.4	43.4	85.5	36.5	43.9	2.3	14.5	44.1
Jute Cuttings	-	-	-	3.2	7.5	17.7	18.2	5.2	1.2	-	-	-	-
Jute Goods	-	-	-	8.2	8.3	10.3	81.0	179.7	212.1	260.0	167.4	164.0	188.7
Hessian	(-)	(-)	(-)	(6.2)	(6.5)	(3.6)	(27.1)	(79.1)	(91.7)	(117.1)	(78.2)	(91.0)	(84.9)
Sacking	(-)	(-)	(-)	(1.0)	(0.3)	(5.9)	(49.8)	(88.0)	(89.9)	(85.6)	(57.9)	(40.6)	(68.4)
Twine	(-)	(-)	(-)	(1.0)	(1.5)	(0.8)	(4.1)	(12.6)	(30.5)	(57.3)	(31.3)	(32.4)	(35.4)

Sources: 1) Ministry of Finance: Economic Survey, Various Issues.
2) Trade Promotion Centre.
3) Nepal Rastra Bank: Quarterly Economic Bulletin, Various Issues.

ing. To elaborate, the principal objective of export trade policy should be to increase the competitiveness of Nepalese exporters in international markets enabling them to fetch higher prices for their products through quality improvements. The main objective of import trade policy should be to formulate an import plan and procure necessary imports at competitive prices and streamline the distribution mechanism.

Geographic and commodity diversification of trade on the basis of comparative advantage should also be accorded priority.

To summarize, the following features are pervasive in Nepal's trade pattern:

a) Commodity-wise and geographical structure of trade have been subject to significant changes.

b) There have emerged marked fluctuations in the behaviour of the individual commodities and markets with reference to their importance in the export and import activities. Trade activities seem to be characterized by a good deal of instability in regard to the commodity and market composition. Items which were significant in one year have sometimes suddenly vanished from the trade data of the next year (see Tables 2, 3, and 4). This sporadic behaviour of trade is attributed to the inherent absence of long-term perspective in trade planning.

c) The shifts in the commodity composition of the exports and imports do not necessarily demonstrate the pattern of the real comparative advantage of the country. This inference can be deduced broadly on the basis of the instability of the variables both in regard to commodities and markets.

d) Among the growing imports necessary for development, capital goods seem pre-eminent. Such imports have been financed partly by international financial resources. But besides being sufficient, these resources bring about a further complication. The burden of servicing them become heavier and heavier, and in some cases the situation is very critical because the exports which provide the necessary funds for servicing are expanding very slowly and losing their purchasing power, while demand for imports continue to grow.

e) Exports increased almost in proportion to the increase in GDP. The proportion of import contents was seen increasing in GDP, and the balance of trade situation was deteriorating (see Table 5).

MAJOR TRADE POLICIES

Exporters' Exchange Entitlement (EEE) Scheme[11]

The EEE scheme was introduced in 1962 and it permitted exporters to overseas countries a bonus in the form of convertible foreign exchange.

	1975/76	1976/77	1977/78	1978/79	1979/80	1980/81	1981/82	1982/83	1983/84	1984/85	1985/86	1986/87	1987/88
Exports/GDP	6.8	6.7	5.3	5.8	4.9	5.9	4.6	3.4	4.5	6.6	6.2	5.2	6.1
Imports/GDP	11.4	11.6	12.5	13.0	14.9	16.2	15.9	18.7	17.1	18.5	18.9	18.9	20.4
Trade Deficit/GDP	4.6	4.9	7.2	-7.1	10.0	10.3	11.1	15.3	12.6	12.0	12.7	13.7	14.4
Primary Goods Exports/Total Exports	87.5	85.5	82.6	78.0	69.5	74.8	80.2	63.6	60.6	55.3	41.9	44.0	36.0

Sources: 1) Ministry of Finance: Economic Survey, Various Issues.
2) Nepal Rastra Bank: Quarterly Economic Bulletin, Various Issues.
3) Own Computations.

The exporters were originally allowed to retain 90 percent of foreign exchange earnings. About 60 percent of their exchange could be spent on goods of their choice and 40 percent was to be expended on imports of development goods approved by the Ministry of Industry and Commerce.

The prime goals of the scheme were to accomplish the objectives of economic independence and trade diversification by the provision of incentives to the exporters to compensate them for the high transit cost due to the land-lockedness of the country. Because of the high rate of bonus attached to exports, the EEE system, to a certain degree, served the objective of trade diversification both country-wise and commodity-wise. For instance, India's share in total exports of Nepal plummetted to 79 percent in 1972/73 and further to 48 percent in 1977/78. Moreover, during the period of operation of the scheme, excluding some traditional export items such as jute, hides and skin, herbs and bristles, a cluster of non-traditional items such as rice, tobacco, cardamom, handicrafts, dry ginger, carpets and tea were exported to about fifty countries. Further, the EEE scheme was also instrumental in the establishment of several trade and/or payment agreements with a number of countries.[12]

However, certain basic flaws became visible in the scheme that produced deleterious effects on the structure and growth of the trade sector. Apart from traditional industries like jute, no other export-oriented industries emerged and agricultural and forest-based products continued to be exported only in raw and unprocessed forms. Moreover, the presence of different exchange rates implied that comparative advantage was not adequately reflected in relative rates of return on exports. Further, the incentives for exporting to overseas countries also involved higher domestic resource costs than was the case with exports to India.

With regard to imports, some distortions emanated in the import pattern and in resource allocation since public enterprises were provided with the facility of convertible foreign exchange at the official rate, while private enterprises were prohibited from it. At the same time, since the export incentives were correlated with and depended on imports being sold at premium prices in the domestic market, the scheme encouraged an unnecessary restrictive import policy towards third countries.

Realizing the detrimental impact of the EEE system, the scheme was terminated on March 30, 1978. Subsequently, the dual exchange rate system was introduced in order to ensure stable incentives to the exporters.

Dual Exchange Rate (DER) and Single Exchange Rate (SER)

The core objectives of the DER scheme which came into effect in 1978 were the diversification of trade to overseas countries and the restriction of imports of luxury goods. Under this scheme, two exchange rates prevailed. The first rate was Rs. 11.90 per US$ (basic) and the second rate was Rs. 15.90 per US$. All receipts from overseas exports were converted at the second rate. Similarly, all imports were converted at the second rate, except imports of certain development goods such as petroleum products, chemicals, fertilizers, certain raw materials, and machinery required for industrial and agricultural development which were provided at the basic exchange rate.

Certain negative repercussions emerged from this exchange rate system. The DER system heavily encouraged imports and importers in comparison to exports and exporters. The importer could import freely at Rs. 15.90 per US$ any amount of luxury goods. Moreover, the private sector was attracted towards the more lucrative import business. This implied reduction of investment and entrepreneurial efforts in the field of exports.

Because the DER scheme could not satisfy its goals, it was replaced by a Single Exchange Rate (SER) scheme on September 19, 1981. Under the SER scheme, all the transactions were to be conducted at a uniform rate of Rs. 13.20 per US$. There were no captivating incentives for exporters exporting to overseas countries, excepting for exporters of a small group of exportable commodities. The rate of subsidy was 10 percent of f.o.b. value for exportable items other than leather and leather goods.[13]

Due to the geographical constraint of land-lockedness, Nepalese exporters encountered heavy transportation cost while conducting trade with overseas countries. The exporters realized that it was not profitable to export to overseas countries under the prevailing subsidy rate. Moreover, the objective of trade diversification was not fulfilled as evinced from the fact that India's share in total exports of Nepal soared from 68 percent to 74 percent between 1981/82 and 1982/83, and the share of overseas countries went down from 32 percent to 26 percent.

The Basket System

Due to the necessity to adjust the exchange rate system towards a more flexible arrangement, an exchange rate system based on a trade weighted basket, with the US dollar as the intervention currency, was introduced in 1983. Indian currency was included in the basket with effect from May, 1986.

The shift towards a basket of currencies was obligated by the excessive volatility and mis-alignment of exchange rates during the early 1980s. This made the exchange rate of the Nepalese rupee more pragmatic and Nepal's exports more competitive, besides protecting the economy from the potential shocks of larger doses of devaluation.

In managing the value of the Nepalese rupee, due emphasis was accorded in ensuring a fair degree of stability in the day-to-day rates. This is more palpably pronounced in the case of Nepalese rupee against the Indian currency where the demand for a fair degree of stability as well as eschewal of undue exchange risks ensuing from too frequent changes, are affirmed. Because of its insertion in the basket the officials may have possessed some flexibility in adjusting the Nepalese rupee-Indian rupee rate misalignments. The uncircumscribed movement of goods, labour and capital through the long open border, and the free and unlimited convertibility of the Indian currency in Nepal has made Nepalese rupee sensitively averse to frequent adjustments.

New Trade Policy and Nine-Point Programme

By mid-1982 the government realized that unless new measures are undertaken, the country's balance of payments situation would deteriorate considerably. Hence, the "New Trade Policy" was announced in June, 1982 where separate but correlated policies for exports and imports were incorporated. The objectives of export trade policy were four-fold: a) generation of employment opportunities by enhancing the production, productivity and qualitative standard of exportable goods; b) establishment of a wide international market for domestic products; c) expansion of the scope of international trade and increment in the level of foreign exchange earnings to satisfy the growing import requirements and to service external debts; and d) to develop contacts with the foreign market for promoting modern technology, skill and management capabilities.[14]

Several programmes were announced to satisfy the foregoing goals. They included, inter alia, a) the formulation of a "product development programme", b) formation of a National Export Trade Development Council, c) production of processed and semi-processed agricultural exportable goods for promoting export capacity, d) pursuance of the policy of diversification of exports both country-wise and commodity-wise, e) expansion of the private sector's role in the trade sector and f) simplification and streamlining of the procedures related to customs assessment. Moreover, it was reiterated that an Export Development Fund would be created in the Nepal Rastra Bank to provide cash subsidy to exporters on the basis of international market conditions, an Export Credit Guarantee Scheme would be introduced and a forward exchange market would be set up.

The objectives of import trade policy were: a) to ensure the availability of essential goods such as capital goods, construction materials, and industrial raw materials for expediting the pace of economic development; b) to provide the people with easy access to those goods that cannot be produced domestically or those that are produced in limited quantity or those that involve high production cost; and c) to expedite the import-substitution process in the agricultural and industrial sectors of the country.

Some prominent programmes in Nepal's import trade included, inter alia, a) framing of a liberal policy towards the import of capital goods, construction materials, industrial raw materials, production inputs and articles of daily consumption, b) protection to agricultural and industrial commodities that could be manufactured domestically on economically viable terms, c) simplification of all administrative procedures related to import trade, and d) formation of a Trade and Supplies Management Committee.[15]

With the upcoming of a new government in 1983, a nine-point export promotion programme was announced on November 1, 1983. The salient features of the programme were: a) constitution of a 14-member Export Product and Export Promotion Council, b) granting of 10 percent cash subsidy on f.o.b. value of exports, c) provision to utilize 15 percent of total earnings for the import of raw materials and capital goods for industries procuring foreign exchange through exports to overseas countries, d) reduction on custom duties on goods exported to third countries to only 1 percent, e) exemption from customs and sales tax to industries exporting their own products, f) permission to exporters to borrow a pre-export loan upto Rs. 2.5 mil. against letters of credit opened by importers, g) granting of necessary refinance by the Nepal Rastra Bank to commercial banks and compensation to the banks for the losses emanating from rebate on interest rate, h) investment by Nepal Industrial Development Corporation of at least 10 percent of its total investment for export-oriented industries and i) establishment of separate units by the commercial banks for export activities at their branches located in various parts of the country.

However both the "New Trade Policy" and the nine-point programme did not bring about satisfactory results as trade data disclose particularly because of administration inefficiency and lack of implementation of the various policies. The policy measures were normally not supervised during implementation, creating constant and often *ad hoc* changes in the *modus operandi*, abating the effectiveness of the prevailing policies and guidelines.

Nepal's exports are lagging not because of sagging export markets, but also because of unwise policies. When money demand is stimulated and imports of consumer goods are sharply restricted, domestic resources are diverted into domestic substitutes and away from export industries. The weak penetrative power of exports is also attributed to the weak stimulus from a particular type of export as well as a host of domestic impediments that limit the transmission of the gains from exports to other sectors. The carry-over from exports has been restrained by various market imperfections such as factor immobility, price rigidity, isolated markets, ignorance of technological possibilities and other traits of economic backwardness.

Devaluation

In November 1985, the Nepalese currency was devalued by 14.7 percent both against the US dollar and the Indian rupee. Consequently, the exchange rate of Rs. 100 I.C. creeped up from Rs. 145 N.C. to Rs. 170 N.C.

Prior to this, the concerned authorities were reluctant to devalue because of the feared inflationary consequences. They should have realized that in a situation where a future devaluation seems unavoidable, however, postponing it for fear of inflation while maintaining the same monetary and fiscal regime merely aggravates inflationary pressures by raising both the probability and the magnitude of devaluation.16

The devaluation of the rupee is a *fait accompli*. Industrialists, traders and the common man had to experience consequences of it, for the better or worse, and make the best of the situation. The aim of devaluation was to inhibit the Indian reserves from falling to a level critical to the country's financial stability and also to stimulate exports and curb down imports with an attempt to narrowing the persistent and increasing trade gap. The likelihood of higher export earnings after devaluation were based on the following premises: a) some of the exportables accounting for relatively small proportion of the total export earnings face elastic demand and as a consequence of permanent inducement provided by devaluation, their sales abroad would expand; and b) the government would take opposite policy measures to check the inflationary process in the economy that otherwise may nullify the advantages offered to the exports by the new exchange rate.

The government did promulgate some measures to tackle the problems of devaluation, but hardly any notable results were attained.[17] The trade scenario was not bright as the trade deficit soared from Rs. 5001.5 mil. in 1984/85 (the year prior to devaluation) to Rs. 6263.2 mil. in 1985/86 (the year of devaluation) and to Rs. 7913.8 mil. in 1986/87 (the year after devaluation). Moreover, the remedial measures to cope with the problem of inflation were not effective. The inflation rates were 4.1 percent and 15.9 percent for 1984/85 and 1985/86, respectively.[18] The double digit figures prevailed till 1987/88.

Breakdown of Indo-Nepal Trade and Transit Treaties and Some Policy Measures

With the termination of Indo-Nepal Trade and Transit Treaties on March 23, 1989, all trade over surface routes with India was confined to two border points, namely, Birganj-Raxual and Biratnagar-Jogbani. The deprivation of the trade and transit points disrupted trade with India, third country trade passing India, and trade between Central and Western Nepal. Both Nepal and India began to employ MFN tariffs to bilateral trade. Hence, Nepalese exports to India were curbed since commodities which hitherto had been excluded from Indian tariffs were governed by Indian MFN customs duties that ranged from 100 to 150 percent. This prompted the Nepalese government to announce a number of measures to expand trade with Third Countries.

a) Custom duties on exports were reduced to 0.5 percent.

b) Necessary arrangements were made for the export of gold ornaments.

c) Cash payments were made to exporters on the basis of f.o.b. price on a number of items, namely, (i) leather goods (25 percent), (ii) finished leather (20 percent), (iii) crossed leather (15 percent), (iv) blue leather (10 percent), (v) pulses (15 percent), (vi) large cardamom (10 percent), (vii) clarified butter (10 percent), (viii) essential oil (15 percent), (ix) dry ginger (10 percent), (x) jute hessian (35 percent), (xi) rosin (18 percent), and (xii) turpentine (18 percent).

d) Import of raw wool under Open General Licence (OGL) without premium was introduced to decrease the production cost of carpets.

e) Additional tariffs on imports were reduced.

f) Imports of basic industrial raw materials were subsumed under OGL.

g) Arrangements were made for Royal Nepal Airlines Corporation (RNAC) to provide a 50 percent discount on air freight for cargo movement to and from Karachi and Dhaka.

The foregoing measures were either nullified or made dormant with the resumption of the Indo-Nepal Trade and Transit Agreements signed on June 9, 1990 by the democratic government.

CONCLUSION

As primary goods comprise the lion's share of Nepal's exports, its exports have remained highly vulnerable to the vagaries of weather and variations in the world commodity prices. This is displayed in the sharp fluctuations in the volume of the country's exports over the years. However, with the substantial increment in the exports of non-primary commodities, the share of primary commodities is gradually shrinking. For instance, the share of primary goods fell sharply from 88 percent in 1975/76 to 36 percent in 1987/88 (see Table 5). A gradual transfer from the exports of primary goods to the manufactured goods would definitely make the export sector less vulnerable to commodity price cycles.

Manufactured export expansion has a beneficial effect on industrial growth. The rise of manufactured exports contributes directly to industrial development via enhancing the share of industry in GDP. Indirectly, by fetching foreign exchange, it permits the inflow of imports stipulated for further industrialization. Moreover, these exports directly involve industrial expansion and mastering of industrial skills.

Hence, Nepal should allocate new productive capacity to manufacturing industries that are capable of competing in the international market. It should identify potential comparative advantage industries and their production should be undertaken at a more rapid pace than is now being conducted. However, the concerned officials should bear in mind the so-called "fallacy of composition argument."[19]

The crucial problem for Nepal is not to select between an export-promotion or an import-substitution strategy alone, but rather to procure the right amalgam of the two strategies. Appropriate domestic policies should be advanced that deploy resources efficiently to internal and external opportunities. Further, fiscal and monetary policies to promote equivalent allocation of resources between import-substituting and export-promoting industries would enable quicker responses to exogeneous changes.

Nepal is vulnerable to external changes and cannot influence world market forces. In foreign trade, as well as foreign capital markets, Nepal is a price-taker, in the sense that it does not have any influence on the determination of terms and conditions of its external transactions. Hence, changes in external factors which would be advantageous to the country must necessarily be exploited to maximum benefit, through timely and vigorous policy measures. Thus, the country's development strategy for the maintenance of balance of payments stability and growth must emphasize the need for a flexible economy which can respond quickly to exogeneous changes.

FOOTNOTES

1. This is the basic point of the theory of comparative advantage. Putting the point differently, the country has the opportunity of choosing among a much more attractive set of options than it would have without trade.

2. Bruce Campbell, "Trade Between Asian Developing Countries: Record and Prospects," Asian Development Review, Vol. 4, No. 2, 1986, p. 58.

3. Human capital includes education, labour skills, health, etc. - investments that raise the productivity of people.

4. For an elaborated illustration of benefits from trade see R. Findlay, "Trade and Development: Theory and Asian Experience," Asian Development Review, Vol. 2, No. 2, 1984, pp. 23-42.

5. Share of India in Nepal's export-import trade for the first and last year of the first four plans are as follows:

(in percent)

Year	Exports	Imports
First Plan		
1956/57	97.9	97.76
1960/61	99.7	94.3
Second Plan		
1962/63	99.5	99.9
1964/65	98.3	98.5
Third Plan		
1965/66	98.1	97.6
1969/70	94.7	91.5
Fourth Plan		
1970/71	81.9	88.2
1974/75	83.9	81.3

Source: Nepal's Foreign Trade Statistics, Various Issues, and Economic Commission Report, Part I, Annex 3.

6. National Planning Commission (NPC), Basic Principles of the Fifth Plan (1975/80), NPC, HMG, Kathmandu, 1973, p. 9.

7. NPC, Basic Principles of the Sixth Plan (1980-85), NPC, HMG, Kathmandu, 1979, pp. 44-45.

8. This data has been compiled from Nepal Rastra Bank, Quarterly Economic Bulletin, Vol. XXI, No. 3 & 4, Mid-April - Mid-July, 1987, p. 44.

9. For instance, export of woolen carpets accounted for 48 percent of total exports to overseas countries in 1983/84.

10. NPC, The Seventh Plan (1985/90), NPC, HMG, Kathmandu, 1985, p. 647.

11. Although the scope of this paper is limited to the period 1975/76 to 1988/89, the EEE scheme of 1962 will also be examined in detail because it was abolished only in 1978.

12. Trade Agreements were established with Yugoslavia (1965), USSR (1970), North Korea (1970), South Korea (1971), and Egypt (1975). Trade and Payment Agreements were conducted with Poland (1966), Bulgaria (1969), China (1974) and Bangladesh (1976).

13. For leather and leather goods, the rate of subsidy was between 10 and 20 percent.

14. For a detailed discussion, see Ministry of Commerce and Supplies, Trade Policy, HMG, Kathmandu, 1982, pp. 3-25.

15. Ibid., pp. 13-18.

16. The work by Himarious with the help of a macro-econometric model supports the argument that expectation of devaluation intensifies inflationary pressures before the devaluation is made effective. For this analysis, see D. Himarios, "Devaluation, Devaluation Expectations and Price Dynamics," Economica, 54, August, 1987, pp. 299-313.

17. The measures included, among others, a) development of a practical system for pre-shipment financing, b) simplification of the procedures and documentation for export licensing, c) development of an evaluation and monitoring system for receipts of foreign currencies on the basis of set export prices and d) provision of bonded warehousing facilities to supply essential inputs for export industries at a lower price.

18. The inflation rates have been computed from data of national urban consumer price index as stated in Nepal Rastra Bank (1987), op. cit., p. 36.

19. According to this argument if all or most developing countries try to find access to the world market for labour-intensive manufactures, the total impact upon this market may become so large that the benefits for each single country are spoiled, as a result either of decreasing prices or of growing market barriers built up by importing countries. For more elaboration, see G. Helleiner, "Manufactured Exports from Less Developed Countries and Multinational Firms," The Economic Journal, Vol. 83, 1973, p. 27.

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